DOCUMENT RESUME

ED 331 349 HE 024 396

TITLE	Perkins Student Loans. Need for Better Controls over Loans Recovered from Closed Schools. Report to the Secretary of Education.
INSTITUTION	General Accounting Office, Washington, D.C. Div. of Human Resources.
REPORT NO	GAO-HRD-91-70
PUB DATE	Mar 91
NOTE	12p.
AVAILABLE FROM	United States General Accounting Office, P.O. Box 6015, Gaithersburg, MD 20877 (1-5 copies, free, additional copies, $2.00 ea., 25% discount on 100+ copies).
PUB TYPE	Information Analyses (070) -- Reports - Descriptive (141)
EDRS PRICE	MF01/PC01 Plus Postage.
DESCRIPTORS	*Administrative Problems; *Assessed Valuation; Evaluation Methods; Federal Aid; Higher Education; *Loan Defau_:; *Loan Repayment; Paying for College; Program Termination; *Property Accounting; School Closing; *Student Loan Programs
IDENTIFIERS	*Perkins Loan Program

ABSTRACT

This report examines the Perkins Student Loan Program, and in particular, the weaknesses in the Department of Education's policies, procedures, and practices for recovering Perkins loan fund assets from schools that go out of business. The report reveals that when schools in the Perkins Student Loan Program close, the Department of Education lacks: (1) adequate guidance for accurately determining the value of assets due from the schools, and (2) a system for calculating and reconciling the value of assets returned with the amounts due. As a result, the Department does not know whether all Perkins assets are being received and accounted for. Additionally, the report reveals that Perkins loans recovered from closed schools are not promptly entered into the Department's debt-collection system, thereby allowing them to be serviced. As of June 1990, the Department had a 10-month backlog of loans to be serviced. Department officials also claimed that they expected school closures to increase further because of recent changes to the Higher Education Act and agreed that delays in recording and servicing loans acquired from closed schools can contribute to increased loan defaults. Conclusions and recommendations are included. (GLR)

United States General Accounting Office

GAO

Report to the Secretary of Education

March 1991

PERKINS STUDENT LOANS

Need for Better Controls Over Loans Recovered From Closed Schools

HE 024 396

GAO/HRD-91-70

GAO

United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-241944

March 27, 1991

The Honorable Lamar Alexander
The Secretary of Education

Dear Mr. Secretary:

At the request of the Senate Committee on Labor and Human Resources and the Subcommittee on Postsecondary Education of the House Committee on Education and Labor, we are conducting a review of the Perkins Student Loan Program. Our review is focusing on identifying cost savings and other improvements in the program. As we are conducting that work, we want to call to your attention weaknesses in the Department's policies, procedures, and practices for recovering Perkins loan fund assets (cash and outstanding loans) from schools that go out of business. Accurate accounting for such assets will become more important since changes in the Higher Education Act to help reduce loan defaults may contribute to additional school closings.

Background

The Perkins Student Loan Program establishes federally subsidized revolving loan funds at postsecondary schools that provide 10-year, 5-percent loans to financially needy students. Schools must provide at least $1 of their own funding for every $9 provided by the federal government. Each school is responsible for administering its fund; including making loans, collecting loan payments, and keeping all loan records.

During the 1989-90 school year, 3,230 schools participated in the program and disbursed about $883 million in Perkins loans. As of June 30, 1989, cumulative federal appropriations had totaled about $6 billion since the program was enacted in 1958 as the National Defense Student Loan Program.

If a school closes, a federal regulation (34 C.F.R 674.17) requires the school to (1) return to the Department of Education the federal share of its fund's liquid assets (cash balance) and (2) transfer its outstanding Perkins loans to the Department or another institution approved by the Department. The total amount of assets a school has in its Perkins fund is referred to in this report as the net federal investment.

According to Department records, 71 schools participating in the Perkins program closed during the last 3 years (July 1, 1987, through June 30, 1990). Department records indicate the net federal investment of these schools was about $21.6 million when they closed.

Scope and Methodology

In conducting this review, we examined applicable laws and Department of Education regulations, policies, and procedures pertaining to the Perkins Student Loan Program. We interviewed and obtained information from officials at the Department's headquarters and 10 regional offices. We reviewed Department memoranda, annual fiscal operations reports submitted by schools, reports from the Department's Office of Inspector General (OIG), the Department's 1989 Financial Integrity Act report, and other Department records. In addition, to obtain an understanding of borrowers' behavior towards repaying and defaulting on student loans, we interviewed industry representatives from three agencies involved in servicing student loans.

Our review was conducted between February and October 1990 in accordance with generally accepted government auditing standards.

Results in Brief

When schools in the Perkins Student Loan Program close, the Department of Education lacks (1) adequate guidance for accurately determining the value of assets due from the schools and (2) a system for calculating and reconciling the value of assets returned with the amounts due. As a result, the Department does not know whether all Perkins assets are being received and accounted for.

Perkins loans recovered from closed schools are not being promptly entered into the Department's debt-collection system, thereby allowing them to be serviced. As of June 1990, the Department had a 10-month backlog of loans to be serviced. Servicing includes, among other things, billing, collecting payments, and contacting borrowers in default. Department officials expect school closures to increase further because of recent changes to the Higher Education Act and agree that delays in recording and servicing loans acquired from closed schools can contribute to increased loan defaults.

Inadequate Internal Controls

Our work and a 1989 OIG audit found that the Department of Education's internal controls over Perkins fund assets obtained from closed schools do not assure that the government's funds are being properly safeguarded. The Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512) specifies that an agency's internal control systems should provide reasonable assurance that funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation. The act requires that an agency's internal control systems comply with internal control standards prescribed by the Comptroller

General.[1] These standards specify, in part, that transactions and other significant events are to be promptly recorded, properly classified, and clearly documented.

OIG Audit Showed Weak Internal Controls

In August 1989, the OIG reported that Department records did not accurately show the amount of assets the Department was owed by closed schools nor how much of this amount had been received or remained outstanding. The OIG concluded that without this information the Department may be unable to recover assets—cash and outstanding loans—from Perkins funds at schools that cease operations.

The Department concurred with the OIG's findings and listed the failure of its systems to properly account for assets recovered from closed schools as material internal control weaknesses in its 1989 Financial Integrity Act Report. It intended to take corrective actions within the year, including setting up a database to monitor the status of all Perkins Student Loan Program participants and establishing procedures for handling assets, especially outstanding loans, from closed schools.

Changes Failed to Establish Adequate Controls

The Department's actions in response to the OIG report did not go far enough to ensure that strong internal controls are in place. Two major problems remain:

1. The Department's procedures lack explicit guidance for its regional offices on how to compute the amount owed by a closed school.

2. In many cases, the amounts of cash and outstanding loans the Department obtains from closed schools are not reconciled with the amounts due.

Inadequate Data and Guidance

Inadequate Department guidance and data on schools' Perkins loan funds are contributing to inaccurate determinations of the amounts due from closed schools. The schools' annual fiscal operations reports to the Department contain such data as the total federal capital contribution, interest income from loans, and loans cancelled or in default. The reports, however, do not include an amount for the net federal investment in schools' Perkins programs. This amount is significant for determining the federal share of the program's assets when schools close.

[1] Standards for Internal Controls in the Federal Government. United States General Accounting Office, 1983.

Without a reported figure for the net federal investment, the Department has to compute this amount from the data contained in the schools' fiscal operations reports. However, the Department provides little guidance on how its regional office staff is to make the computation. This has led to errors and inconsistencies. Our discussions with representatives from each of the Department's 10 regional offices indicate errors in some of their determinations of net federal investment.

Amounts Returned Not Calculated or Reconciled

In 8 of the 10 regional offices, the Department does not know whether closed schools are turning over all their Perkins loan fund assets to the federal government or what further recovery efforts are needed. Only two regions have calculated and reported the value of their recovered outstanding loans to headquarters. Three regions performed partial reconciliations of the amount recovered from closed schools.

Department policies do not require that such reconciliations be made, and, generally, they are not performed. To determine whether all Perkins assets have been recovered from a closed school, the Department needs to calculate the value of the assets obtained and reconcile this value with the amount due the government. One regional official said that the region does not perform reconciliations because it lacks time and expertise. An official in another region said that only the most obvious comparisons are made to reconcile the amount due with the amount collected. An official in a third region said that they do not balance a school's account; rather, they just record the cash on hand and loan records from the school. After the regions transfer Perkins fund assets to the Department's Debt Collection and Management Assistance Service, the Service does not reconcile closed schools' loan portfolios, either.

Loan Servicing Backlog Could Increase Defaults

As of June 1990, the Department had a backlog of about 4,000 loans valued at about $1.7 million that it had received from closed schools. The loans were neither entered into its debt-collection system nor actively being serviced. This represented a 10-month backlog of loans that were not being serviced. The timely recording of loans is important because any delay in servicing them may cause loss of contact with borrowers and lead to increased defaults.

According to a June 11, 1990, Department memorandum, this backlog occurred because the contractor entering loans in the system is limited to processing a maximum of 400 loans per month. At this rate—and

conservatively assuming no further loans are transferred to the Department—some of the loans in the backlog may wait about 10 months before they are recorded and borrowers are contacted. Department representatives from four regions said that they are holding loan records from at least 14 schools that are awaiting entry into the Department's system as a result of the backlog. One official told us that his staff is not pursuing the retrieval of loan records from two schools because the records will just "sit around" once they are recovered.

Department officials said the backlog exists primarily because the Department lacks the resources to increase the contracted loan processing. One of these officials said plans are to increase the contract capacity, but, as of December 31, 1990, no action had been taken.

The failure to promptly service loans could result in a greater number of loans going into default if the Department loses contact with borrowers. Experiences of private sector collection agencies suggest that many loans being repaid at the time a school closes will fall into default if borrowers are unclear where to send their payments. Usually it is more difficult to locate these borrowers once contact is lost and repayment stops. Also, failing to service loans promptly is a disservice to students who want to pay back their loans. Students' loans may go into default—through no fault of their own—if they do not know where to send payments and no one contacts them with this information.

1990 Legislation May Increase School Closures and Loan Processing Backlog

The Omnibus Budget Reconciliation Act of 1990 contains a number of measures that may indirectly increase school closures in the next year. One of the law's provisions could result in decreased eligibility of some schools for the Stafford loan program.[2] The law also delays loan disbursements to first-time Stafford borrowers until 30 days after the borrower begins a course of study.

These restrictions are also likely to impact the Perkins Student Loan Program because many schools with Perkins loan funds also participate in the Stafford program. A Department of Education official said that many of these restrictions will apply to marginal schools that are highly dependent upon federal financial aid. He added that without student access to Stafford loans many of these schools may close. This official estimated that over 300 schools participating in the Stafford program

[2] Stafford loans—for needy undergraduate, graduate, and vocational students—are low-interest loans subsidized and guaranteed by the federal government.

are likely to become ineligible because of the new restrictions and he expects that a portion of these will probably close as a result.

Conclusions

The Department of Education's internal control system is insufficient for recording and accounting for Perkins loan fund assets received from schools that close. Without adequate written policies and guidance, Department personnel are relying on ad hoc methods to determine whether fund assets are being recovered and accounted for. This contributes to inaccurate determinations of a closed school's assets and unnecessary losses to the government.

The Department has a backlog in its servicing of some loans received from closed schools. For some loans, processing delays result in loss of contact with borrowers and contribute to an increase in loan defaults. Recent legislation may result in additional school closures causing the Department to receive more loans in need of processing. As this occurs, processing delays will lengthen and more defaults will occur unless the Department initiates timely corrective action.

Recommendations

To provide reasonable assurances that its Perkins Student Loan Program assets are being properly safeguarded from loss, we recommend that the Secretary of Education

- revise the Department's policies and procedures to provide guidance for (1) accurately determining the net federal investment in schools' Perkins loan funds and (2) promptly reconciling the amount of each closed school's cash and outstanding loans with the net federal investment in the fund, as recorded by the Department; and
- increase the Department's capacity for the timely processing of loans from closed schools.

Federal law (31 U.S.C. 720) requires you to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of this report. You are also required to submit a written statement to the Senate and House Appropriations Committees with the agency's first request for appropriations submitted more than 60 days after the date of this report.

We are sending copies of this report to the Senate and House Appropriations Committees, the Senate Committee on Labor and Human Resources, and the Subcommittee on Postsecondary Education of the House Committee on Education and Labor. We will also make copies available to other interested parties on request.

If your staff would like to discuss these issues or has any questions, please contact Jay Eglin, Assistant Director for Higher Education Programs, at (202) 401-8623. Other major contributors to this report are listed in appendix I.

Sincerely yours,

Franklin Frazier

Franklin Frazier
Director, Education and
Employment Issues

Major Contributors to This Report

Human Resources Division, Washington, D.C.

Joseph J. Eglin, Assistant Director

Seattle Regional Office

Charles M. Novak, Regional Education Issue Area Manager
Charles H. Shervey, Evaluator-in-Charge
Jane A. Dunkel, Evaluator
Stanley G. Stenersen, Evaluator

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